In the Supreme Court of the United States

OCTOBER TERM, 1958

F. STRAUSS & SON, INC.,
Petitioner,
vs.
COMMISSIONER OF INTERNAL REVENUE,
Respondent.

No. 50.

Brief of Bay Cities Transportation Company Amicus Curiae

On Certiorari to Review a Decision of the United States Court of Appeals for the Eighth Circuit.

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STATEMENT OF INTEREST OF AMICUS CURIAE

This amicus curiae is plaintiff in a suit for refund of federal income taxes now pending in the United States Court of Claims and entitled *Bay Cities Transportation Company v. United States of America.*[1] Its interest in these proceedings derives from the pendency of that suit, which involves the question whether expenditures relating to an initiative amendment to the California constitution, voted on by the electorate, are deductible as ordinary and necessary business expenses.

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1. Docket No. 282-57.

SUMMARY OF ARGUMENT

First: Section 23(a)(1)(A) of the 1939 Internal Revenue Code allows a deduction for "all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business". The aim of the statutory provision is to confine the burden of the income tax to "net income", that is, gross income *after* deducting "the ordinary and necessary expenses incurred in efforts to obtain or to keep it". *McDonald v. Commissioner*, 323 U.S. 57, 67 (1944). If it does this, and does it well, it has accomplished enough for one law. If it departs from this primary objective, it has failed in its purpose.

Second: The expense in the instant case was not illegal. Neither did it violate or frustrate any public policies—much less "national or state policies evidenced by some governmental declaration" thereof. *Lilly v. Commissioner*, 343 U.S. 90, 97 (1952); *Tank Truck Rentals, Inc. v. Commissioner*, 356 U.S. 30, 33 (1958); *Commissioner v. Sullivan*, 356 U.S. 27 (1958).

Petitioner was defending its very existence. It campaigned against a ballot measure in a perfectly forthright, open and legal manner, in keeping with the statutes and policies of the State of Arkansas. In modern society, the effective exercise of the right to engage in public debate costs money. To espouse the right, but to condemn the expenditure of funds for its effective exercise is mere cant. This Court has held that an expense incurred to preserve a business from destruction is an ordinary and necessary business expense. *Commissioner v. Heininger*, 320 U.S. 467 (1943). The fact that the attack on petitioner's business came by way of an initiative measure does not make resistance to it any the less "ordinary" or "necessary"; and the Commissioner should not, merely because an initiative

measure is involved, inject new standards of deductibility, foreign not only to the tax law but to the statutes and policies of the State of Arkansas.

Third: The expense does not fall within the ambit of the Commissioner's regulation disallowing expenditures "for lobbying purposes, the promotion or defeat of legislation". Regs. 111, Sec. 29.23(q)-1. This regulation, on its face, is a severe limitation on the statutory words "ordinary and necessary"—a limitation which can only be justified by giving to the regulation a restrained construction compatible with the declared policies of Congress and the states which relate to lobbying and legislative matters. The Commissioner and the courts have long recognized that the regulation is directed at expenditures which violate established policies regarding lobbying and legislative activities. For example, this Court has approved the application of the regulation to disallow expenditures under a *contingent fee lobbying contract. Textile Mills Corp. v. Commissioner*, 314 U.S. 326 (1941). In that case this Court pointed out that the Commissioner may, by regulation, appropriately draw a line "between *legitimate* business expenses" and those which violate the "general policy [on legislative expenses] indicated by" cases such as *Trist v. Child,* 21 Wall. (U.S.) 441, and *Hazelton v. Sheckells,* 202 U.S. 71 (holding that "contracts for a contingent compensation for obtaining legislation were void", 202 U.S. at 79). This Court further observed that a valid regulation could not "contravene(d) any Congressional policy", and pointed out that at that time (1941) there had been no "clear Congressional action" on the subject of legislative activities. *After* the *Textile Mills* decision, the "general policy" on lobbying and legislative activities was spelled out by "clear Congressional action" in the Federal Regulation of Lobbying Act, 60 Stat. 839 (1946), 2 U.S.C. §§ 261-70 (1952).

In line with the reasoning in the *Textile Mills* decision, the regulation should be interpreted to accord with the "general policy" on legislative expenditures now expressed in this Act *as well as* in the decided cases such as *Hazelton v. Sheckells, supra.* This does *not* mean any *relaxation* in the conditions of deductibility. Rather it means that an expenditure must comply *both* with the "general policy" of *Hazelton v. Sheckells and* with the disclosure requirements and other safeguards of the Federal Regulation of Lobbying Act. This construction will put additional teeth into the latter Act. Similarly, the regulation should complement, and not conflict with, *declared state policies* where state enactments are involved. In particular, the regulation should be interpreted to accord with *declared state policies* relating to expenditures for *initiative* measures such as those here made.

In a word: the situation with respect to lobbying and legislative expenses is not unlike that with respect to "penalties"; and the incisive observations made by Judge Learned Hand in *Jerry Rossman Corporation v. Commissioner,* 175 F.2d 711, 713 (2d Cir. 1949), are peculiarly apt. In that case Judge Hand, speaking for the court, held that the "penalties" for OPA overcharges there involved were deductible, reasoning as follows:

> "The Revenue Act does not declare that penalties may not be deducted; *the doctrine is a judicial gloss* * * * We agree that it is a proper gloss. * * * Hence, if one rigorously applied the doctrine, a taxpayer could never deduct the payment of fines and forfeitures; * * * The Supreme Court overruled this doctrine in *Commissioner v. Heininger, supra;* * * * We think that * * * *there are 'penalties' and 'penalties,' and that some are deductible and some are not.* * * * *We hold therefore that in every case the question must be decided ad hoc.*"

To the same effect see *Tank Truck Rentals, Inc. v. Commissioner, supra; Commissioner v. Sullivan, supra; Commissioner v. Pacific Mills*, 207 F.2d 177 (1st Cir. 1953).

So it is with the instant regulation. We suggest that there are "lobbying" expenses and "lobbying" expenses; that there are "expenses for the promotion or defeat of legislation" and "expenses for the promotion or defeat of legislation"; and some are deductible and some are not. In every case the question "must be decided *ad hoc*". The test we submit is whether the "lobbying" or the activities for "the promotion or defeat of legislation" in the particular case "frustrate sharply defined" or "governmentally declared" policies. Moreover, the Commissioner may not fashion an all-embracing regulation and then defend it *on the ground that the regulation itself constitutes a declared public policy.* Such reasoning would make a farce of the "public policy" tax doctrine. In sum: *the tax regulation should be read in the light of the declared federal policies which exist with respect to lobbying and legislative activities; and, similarly, it should be read in the light of declared state policies which exist with respect to initiative measures.*

Fourth: If the re-enactment rule has any significance, it supports the position of petitioner in this case.

ARGUMENT

I. The Contribution Is Deductible as an Ordinary and Necessary Business Expense. It Was Not Illegal. It Frustrated No Public Policies.

Section 23 of the Internal Revenue Code of 1939 permits deduction from gross income of "all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, * * *".

The purpose of the statute is to determine a "net income" upon which the tax may be levied; and the section specifies its own criteria of deductibility. The outlay must be a "business expense"; it must be "ordinary"; and it must be "necessary". The statute provides no less and no more. It calls for an empirical approach.

The only gloss which the courts have imposed on the meaning of the statutory words has been cast in terms of "illegality" or "public policy". For example, it has been held that expenditures which are *illegal* are not deductible. *Boyle, Flagg & Seaman, Inc.*, 25 T.C. 43 (1955); *R.E.L. Finley*, 27 T.C. 413 (1956); *Lorraine Corporation*, 33 B.T.A. 1158 (1936); *Kelley-Dempsey & Company*, 31 B.T.A. 351 (1934). Similarly, deductions which frustrate the policy of other laws are not allowable. *Tank Truck Rentals, Inc. v. Commissioner*, 356 U.S. 30 (1958).

No such problem exists in the present case. Expenditures by persons interested in ballot measures are not only countenanced in Arkansas; they are contemplated. The state statutes do not prohibit expenditures in behalf of or in opposition to ballot proposals. On the contrary, the assumption is that such expenditures *will be made*, and the statutes merely limit the amount which may be expended by protagonists of the ballot measure and require that such persons file with the Secretary of State an account of their expenditures. Ark. Stat. Ann., Sec. 3-1303 (1947); see also Arkansas State Constitution, Amendment 7, Section 1.

It is thus apparent that the expenditure of funds by plaintiff and others similarly situated to disseminate their views on a proposed initiative being submitted to the general electorate did not violate any "sharply defined" or "governmentally declared" policy of the State of Arkansas. The boundaries of permissible activity in respect of ballot

proposals having been delineated by statute in Arkansas, it is not for the Commissioner to redraft these boundaries to suit some vague notions of public policy nowhere defined.

It may be said that petitioner was interested in disseminating facts favorable to only one side of the measure; that to permit deduction creates an indirect subsidy to this side. But there were no doubt others on the opposite side, as in most questions which are the subject of public debate. The expenditures on either side may be "good" or "bad", depending on the point of view. Who is to say whether the money is being spent to "propagandize" the public or to "educate" the public? Whether the campaign is to "bring out the facts" or "obfuscate the issue"?

In fashioning the taxing statute, Congress very wisely avoided these side issues. Under the tax law the question is cast in terms of whether the expenditure is "personal" (and therefore nondeductible) or "business" (and therefore deductible). In addition, it must be *"ordinary"*; it must be *"necessary"*; it must not be *illegal*;[1] and it must not frustrate *declared public policies*.

Further than this the courts should not go in trying to shape public conduct through use of the tax statute. In particular, the courts should not construe the tax statute so as to *condemn* conduct which is *expressly sanctioned* by the declared public policies of the state.

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1. It may be noted in passing that expenditures by corporations for political purposes and the like are either prohibited or carefully controlled by statutes such as the Federal Corrupt Practices Act, 43 Stat. 1070 (1925), as amended 2 U.S.C. §§ 241-56 (1952) [the portion here relevant is now codified as positive law in 18 U.S.C. § 610 (1952)] and the Hatch Act, 53 Stat. 1147 (1939), as amended 5 U.S.C. § 118-n; 18 U.S.C. §§ 594-611 (1952). The tax regulation should, of course, be construed to backstop these direct statutory provisions. But it should not go beyond this to *condemn* activities which the declared policy of such statutes expressly *sanctions*.

II. Deduction of the Expenditures Is Not Barred by the Commissioner's Regulation.

For many years the income tax regulations have contained the following provision:

> "Sums of money expended for lobbying purposes, the promotion or defeat of legislation, the exploitation of propaganda, including advertising other than trade advertising, and contributions for campaign expenses are not deductible from gross income." Regs. 111, Sec. 29.23(q)-1.

Respondent apparently contends that this regulation bars deduction of the expenses here involved. We maintain it is not applicable for two reasons: (a) The regulation is not applicable by its terms; and (b) The scope of the regulation should not be expanded by inference.

(a) The Regulation Is Not Applicable by Its Terms.

The scope of the regulation ought in the first place to depend on the words used. The fact is that the money here involved was not "expended for lobbying purposes". The content of the word "lobbying" may have some flexibility, but it certainly does not encompass the kind of general publicity program addressed to the voters at large which was carried on in this case. See *United States v. Rumely*, 345 U.S. 41, 47 (1953), in which this Court pointedly observed that the commonly accepted meaning of the word "lobbying" is "representations made directly to the Congress, its members, or its committees"; and that the meaning does not extend to a generalized publicity program designed to reach "the thinking of the community".

It is equally plain that the expenditure here involved was not for "the promotion or defeat of *legislation*". In the *Rumely* case, this Court indicated that the words "influence legislation" normally connote action directed at *representa-*

tive legislative bodies. The Commissioner has conceded as much by his public acquiescence in the case of *Luther Ely Smith,* 3 T.C. 696 (1944), acq. 1944 C.B. 26.[1] In the *Smith* case, a lawyer was allowed to deduct sums of money spent for the promotion of an *initiative amendment* to the state constitution which would have affected his profession. The court held the contribution deductible, saying:

> "It should be noted that the institute engaged in *no lobbying* of any kind before any *legislative body.* No legislation was needed or involved in its plan. It contemplated an amendment to the constitution, proposed by the initiative of the people, voted upon at a general election, and becoming self-operative thirty days thereafter, *without the necessity of any action or approval by either the legislature or the governor."* (p. 702)

The *Smith* case involved an *initiative constitutional amendment* while the instant case concerns an *initiative statutory measure.* This difference, however, is of little relevance. The Tax Court in the *Smith* case stated the grounds of its decision with clarity, i.e., that "No *legislation* was needed * * * the institute engaged in no lobbying of any kind before any *legislative body* * * * It contemplated an amendment * * * without * * * any action * * * by * * * the *legislature."* It is impossible to preceive any basis in policy for a distinction between expenditures in respect of a constitutional amendment *voted on by the electorate* and expenditures in respect of a statutory measure *voted on by the electorate* which would justify allowance of a deduction in the one instance and denial in the other.

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1. Fourteen years later—and after certiorari was granted in *Cammarano v. United States,* 246 F.2d 751 (9th Cir. 1957), cert. granted 355 U.S. 952, and on the same day that certiorari was granted in this case, 356 U.S. 966, the Commissioner withdrew his acquiescence. Rev. Rule 58-255, 1958 Int. Rev. Bull. No. 21, at 16. But this was not until after occurrence of all the material facts of this case and entry of the judgment below.

For fourteen years the standing of the *Smith* decision was beyond question. It was reviewed by the entire court. It was a unanimous decision. And it was "acquiesced" in by the Commissioner. The Internal Revenue Bulletin in which the Commissioner's acquiescence was published states that:

> "In order that taxpayers and the general public may be informed whether the Commissioner has acquiesced in a decision of The Tax Court * * * announcement will be made in the semimonthly Internal Revenue Bulletin * * * *Decisions so acquiesced in should be relied upon* * * * *as precedents in the disposition of other cases.*" (1944 C.B. page iv.)

Although the Commissioner has now belatedly withdrawn his acquiescence, it was in full force and effect for 14 years and at all times material to the issues of this case. At least during this 14-year period the Commissioner ought to be required to honor his *own* interpretation of his *own* regulation—an interpretation which is consistent with the decisions of this Court and the applicable federal and state policies.

In sum, the word "legislation" ordinarily refers to statutory enactments *by the legislature.* This normal construction accords with the apparent purpose of the regulation to insure that "insidious" lobbying arrangements will not operate in *"legislative halls", Textile Mills Corp. v. Comm'r,* 314 U.S. 326 (1941); and it accords with the Commissioner's own interpretation of his regulation.

(b) The Regulation Should Not Be Expanded by Inference.

It remains to be considered whether the regulation should be extended by inference to cover the expenditures here considered. In *Luther Ely Smith, supra,* The Tax Court decided not. By his published acquiescence the Commis-

sioner agreed. And there is ample reason for their restraint. The statute permits deduction of business expenses which are "ordinary and necessary". The Commissioner, by regulation, maintains that a business expense is not "ordinary and necessary" if it is for "the promotion or defeat of legislation". This is a *non sequitur*,[1] even *before* the meaning of the word "legislation" is extended to include

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1. There is no policy justification for using the "meat-ax" approach to this class of expenditures. The many state and federal statutes *dealing selectively* with these activities bear witness to that. Political scientists, statesmen, and other writers have uniformly noted that activities for the promotion or defeat of legislation are not bad *per se*. On the contrary they are a necessary and beneficial aspect of a complex industrial society.

The observations of the late Senator Robert M. La Follette, Jr., author of the 1946 Legislative Reorganization Act (of which the Federal Regulation of Lobbying Act is a part), whose knowledge of and interest in this problem has been equaled by few people, are highly significant:

> "Lobbying may be a pernicious evil at one extreme or an indispensable part of the legislative process at the other, depending on the circumstances and the methods of lobbyists. Few, if any, legislators could hold a brief for the avaricious, anti-social or unscrupulous tactics to which some special interests sometimes resort; but even fewer would be willing to abolish lobbying and cut off essential sources of information in exchange for 'protection' against the unscrupulous.
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> * * * * * * *
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> "Efforts to curb the abuses of lobbying have been directed generally at the objective of full disclosure of sponsorship and expenditures. The force of public opinion, it is reasoned, will then be brought to bear on its abuses. That is the theory too on which most of the state laws on lobbying have been based. Massachusetts passed the first lobbying law in 1890 and about thirty-five states now have such laws with varying provisions and varying degrees of enforcement.
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> * * * * * * *
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> "By and large, however, lobbying reflects the complexity of our society and Government. The bulk of it is a representation of viewpoints and interests which should be and are considered in the legislative process." *New York Times Magazine*, May 16, 1948, page 15.

Similar views are contained in the final report of the House Select Committee on Lobbying Activities, H. Rep. No. 3239, 81st Cong. 2d Sess., 1951, p. 4; "Labor on Capitol Hill", *Fortune Maga-*

initiative measures not acted on by the legislature. And this Court made it unmistakably plain in the *Textile Mills* case that the content of the regulation must not "contravene(d) any Congressional policy" and should take account of "Congressional action". Similarly, the regulation must be construed in a manner consistent with declared *state* policies relating to *state* initiative measures.

Arkansas has adopted its own canons of behavior in respect of direct popular sovereignty. Ark. Stat. Ann. §§ 3-1301—3-1313; Arkansas State Constitution, Amendment 7, Sec. 1. Here are the "state policies evidenced by some governmental declaration of them" to which this Court adverted in the *Lilly* case. The boundaries of permissible activity having been thus delineated, it is not for the *taxing* authority to *frustrate* such policies by affirmatively inflicting a penalty.

To paraphrase Judge Learned Hand:[1] there are "lobbying" expenses and "lobbying" expenses; there are "expenses for the promotion or defeat of legislation" and "expenses for the promotion or defeat of legislation"; and some are deductible and some are not. In every case the question "must be decided *ad hoc*". The test we submit is whether the "lobbying" or the activities for "the promotion or defeat of legislation" frustrate "sharply defined" and "governmentally declared" policies exemplified, for example, by the Federal Regulation of Lobying Act or by state statutes governing conduct in legislative or initiative matters. The

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zine, March 1949, Vol. 39, pp. 177-8; "Lawyers and Lobbyists", *Fortune Magazine*, February 1952, Vol. 45, pp. 127-8.

It may also be noted that Canon 26 of the Canons of Professional Ethics of the American Bar Association, 62 Reports of American Bar Association 1105, 1114, specifically approves the performance of proper lobbying and legislative services by attorneys.

1. Jerry Rossman Corporation v. Commissioner, 175 F.2d 711, 713 (2d Cir. 1949).

policy which the tax law should strive for is to determine "net income" fairly and accurately; and to do so without "frustrating" other laws or declared public policies. The Commissioner should not be permitted to use his tax regulations as an *independent* source of policy-making authority. In particular, there is no policy justification whatsoever for construing the Commissioner's regulation so as to *condemn* conduct *expressly sanctioned* by the declared policies of Arkansas.

III. The Re-enactment Rule Supports Petitioner's Contentions.

Criticism of the re-enactment rule has ranged all the way from the comment that "re-enactment * * * is an unreliable indicium at best", *Commissioner v. Glenshaw Glass Co.,* 348 U.S. 426, 431 (1955), to the suggestion of one recognized authority that "the mere re-enactment of a statute following administrative construction should be given no weight whatever in determining the proper construction of the statute". Griswold, *A Summary of the Regulations Problem,* 54 Harv. L. Rev. 398, 400 (1941). See also Surrey, *The Scope and Effect of Treasury Regulations under the Income, Estate and Gift Taxes,* 88 U. Pa. L. Rev. 556 (1940).

We cite the foregoing authorities to make it clear that we are not interested in defending the re-enactment rule as a reliable indicium of statutory construction. We say only this: if the re-enactment rule has any significance, it supports the position of petitioner in this case.

First: The re-enactment rule cannot make an *invalid* regulation *valid.* "A regulation which does not carry into effect the will of Congress as expressed in the statute, and which operates to create a rule out of harmony with the statute, is 'a mere nullity'." *Studies in Federal Taxation,* p. 435 3d Series, Randolph E. Paul; *Koshland v. Helvering,* 298 U.S. 441 (1936).

Second: There is no provision in the tax law authorizing a specific regulation defining the terms "ordinary and necessary" and the only power of the Commissioner is the general power conferred by the Internal Revenue Code to make appropriate regulations. Int. Rev. Code 1939, Sec. 3791; *Koshland v. Helvering, supra.*

Third: A priori, there is is nothing in the words "ordinary and necessary" which excludes expenses for the promotion or defeat of legislation. Consequently, the Commissioner's effort to import this limitation into the words must be given a reasonable construction by the courts to save it.

Fourth: As pointed out in petitioner's brief, the vast majority of the decisions construing the Commissioner's regulation in the period between 1918 and 1939, when the re-enactment rule may be said to have had some force, are in accord with the construction urged in this brief and that of petitioner.

If we are to attribute to Congress an intent to incorporate into the statute by re-enactment the developing content of the regulations through judicial interpretation, we should incorporate the full picture as Congress saw it. The full picture in 1950 includes a clear rule that the regulation does not bar deduction of *legitimate* expenditures in connection with *initiative* measures voted on by the *electorate.*

CONCLUSION

The states and Congress are at liberty to regulate activities in connection with the law-making process. Tax deduction rules should not violate these laws or frustrate the policies they foster. By parity of reasoning, the Commissioner's regulations are not an independent source of

policy-making authority which may *condemn* conduct expressly *sanctioned* by the declared policies of the state.

The expenses which petitioner incurred in this case were deductible as ordinary and necessary business expenses.

Respectfully submitted,

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